NWA Inc. 1985 Annual Report

Contents

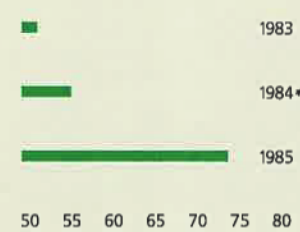
Highlights

Operating Revenues

(Billions of Dollars)

Net Earnings

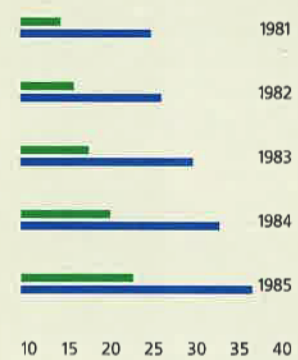
(Millions of Dollars)



Revenue Passenger-Miles and Available Seat-Miles

(Billions)

RPM's ASM's



Year Ended December 31	1985	1984	1983
Total Operating Revenues	**$2,655,491,000**	$2,444,974,000	$2,196,036,000
Operating Income	**77,087,000**	96,276,000	68,886,000
Net Earnings for the Year	**73,119,000**	55,964,000*	50,073,000
Per Common Share	**3.18**	2.44*	2.19
Per Dollar of Revenue	**2.8¢**	2.3¢	2.3¢
Stockholders' Equity	**$ 947,001,000**	$ 892,923,000	$ 854,189,000
Per Common Share	**43.49**	41.05	39.33
Dividends Paid	**19,586,000**	17,933,000	17,367,000
Operating Expenses:			
Per Available Ton-Mile	**39.8¢**	40.2¢	40.5¢
Per Available Seat-Mile	**6.8¢**	7.1¢	7.1¢
Revenue Traffic (Scheduled):			
Passengers Carried	**14,539,000**	13,216,000	12,718,000
Passenger-Miles Flown	**22,341,334,000**	19,772,355,000	17,711,929,000
Ton-Miles, Mail, Freight & Express	**1,100,124,000**	1,126,564,000	979,753,000
Common Shares at Year End	**21,774,000**	21,750,000	21,716,000
Employees:			
Number at Year End	**16,641**	15,185	14,187
Total Wages & Benefits Paid	**$ 715,172,000**	$ 639,606,000	$ 569,535,000

*After extraordinary charge of $30,903,000 or $1.30 per share resulting from the settlement of a lawsuit.

Corporate Profile NWA Inc. is engaged primarily in the commercial transportation of passengers, freight and mail through its wholly-owned subsidiary Northwest Airlines, Inc., a scheduled U.S. air carrier. Northwest's current route system spans 73 cities in 26 states and 17 countries in Western Europe and the Far East, where Northwest is the dominant U.S. airline. Northwest was the seventh largest U.S. carrier in terms of revenue passenger-miles in 1985, and its freight operations ranked number one in terms of freight ton-miles among all U.S. combination carriers. NWA Inc. is also the parent company of Mainline Travel, Inc., a major wholesaler of vacation travel packages that was acquired in 1985. In January 1986, NWA Inc. entered an agreement to acquire Republic Airlines. If this acquisition receives all necessary approvals, Northwest will become the third largest carrier in the U.S. airline industry based on 1985 total revenue passenger-miles. NWA Inc. is headquartered at Minneapolis/St. Paul International Airport and its common stock is traded on the New York Stock Exchange.

NWA Inc. President and Chief Executive Officer Steven G. Rothmeier with employees.

1985 Annual Report To Shareholders One of the most significant developments in the 59-year history of Northwest Airlines occurred in January 1986, when NWA Inc. entered into an agreement to acquire Republic Airlines. Pending approval by Republic's shareholders and the federal government, which we hope to have later this spring, the combined operations resulting from the $884 million transaction will rank Northwest third largest among all U.S. carriers in terms of revenue passenger-miles.

In acquiring Republic we are bringing together two medium-sized airlines with complementary fleets and routes into a single coherent system. By doing so, Northwest will create increased domestic mass that will improve our competitive position in a deregulated and intensely competitive environment.

The year 1985 was important for Northwest from the standpoint of implementing strategies designed to foster growth and enhance our competitive capability. Toward these ends, we invested heavily in state-of-the-art aircraft, strengthened our domestic system and took a step toward vertical integration at NWA Inc.

We achieved good operating and financial results in 1985 in the face of strong competition and general difficulties affecting the U.S. airline industry. Operating revenues rose 8.6 percent in 1985 to an all-time high of $2.65 billion. Operating income amounted to $77.1 million, compared to $96.3 million in 1984. Net earnings for the year totaled $73.1 million or $3.18 per share, compared to the $56.0 million or $2.44 per share in 1984. Net earnings in 1984 were reduced by an extraordinary charge of $30.9 million or $1.30 per share, resulting from the settlement of a 15-year-old lawsuit at Northwest.

A 7.6 percent decline in freight revenues was a significant factor limiting higher revenue and earnings growth in 1985. This drop was attributable largely to weak U.S. exports, reflecting the strength of the U.S. dollar as well as only moderate increases in consumer spending for air eligible items. Northwest's earnings growth was further restrained by a 4.0 percent decrease in yield per revenue passenger-mile, a direct result of intense competition as well as the longer haul makeup of our route system, where the average passenger traveled 1,537 miles in 1985, up from 1,496 miles in 1984. The largest decrease in yield was recorded in our domestic system due to the continuing industrywide availability of discounted fares. The effect on operating income of revenues lost due to freight and yield declines was only partially offset by an overall increase in passenger and mail traffic and lower operating unit costs.

Revenue passenger-miles rose 13 percent in 1985 as we increased our market share among major U.S. airlines for the seventh consecutive year. Our 1985 RPM growth was spread uniformly throughout Northwest's route system. Equally important, our systemwide passenger load factor of 60.1 percent remained practically unchanged in 1985 despite competitive pressures and an aggressive 13.7 percent increase in available seat-miles.

Our 1985 results were also favorably affected by the efficiencies of our growing fleet of Boeing 757 aircraft, which was one of the major factors enabling us to reduce operating costs per available seat-mile by 4.6 percent to 6.78 cents. Northwest was operating eleven 757s by year-end, and these aircraft have met or exceeded all of our expectations. In 1985 we entered into the largest aircraft order in Northwest's 59-year history with commitments for 23 additional aircraft valued at $2 billion. The aircraft to be delivered over the next five years are three long-range 747-200s, ten more Boeing 757s, and ten new-generation 747-400s.

The new direction of the airline industry under deregulaton requires that we add substantial capacity in order to remain competitive and capitalize fully on the opportunities available throughout our global system. For example, the decision of the U.S. Department of Transportation to permit United Airlines to acquire the transpacific operations of Pan American means that Northwest will be facing even stiffer competition in the Pacific, where we are the leading U.S. carrier. To help meet this challenge, we became the launching customer for the new-technology Boeing 747-400 with our order for ten aircraft. The 747-400, developed to Northwest's specifications for our Pacific routes, will set the standards for efficiency and passenger comfort in Pacific markets throughout the 1990s.

On the domestic side, the efficiency and flexibility of our 757s permitted us to make major strides toward strengthening our domestic system in 1985. During the year, we improved domestic service with significant increases in frequencies and nonstop scheduling in key markets. We also used our 757s to provide higher volumes of feeder traffic into our eight international gateways. Nine previously ordered 757s will be added to our fleet in 1986.

Our $2 billion aircraft orders will be financed through a combination of internally generated funds and the placement of debt. Relying on some carefully managed debt is necessary to finance expensive new aircraft and other long-term growth strategies. Traditionally, Northwest has purchased rather than leased its aircraft. However, recent changes in tax laws have made it advantageous to lease aircraft under certain conditions, and we are now leasing five of our 757s with options to purchase them at low fixed prices at the expiration of their leases. This type of leasing arrangement was not previously available and use of it at this time is a proper and desirable form of financial management.

In other significant developments, we signed "Northwest Orient Airlink" agreements with America West Airlines in Phoenix, Big Sky Airlines in Billings, Montana, and Fischer Bros. Aviation in Detroit. Like Mesaba Airlines, which entered an Airlink agreement in late 1984, these three carriers are now coordinating their flight schedules with us and providing Northwest higher volumes of feed traffic in our markets.

Another important move in 1985 was our acquisition of Mainline Travel, Inc. (MLT), which became a wholly-owned subsidiary of NWA Inc. MLT is a tour wholesaler, marketing travel packages through more than 7,100 independent retail travel agencies. With annual revenues in the area of $100 million, MLT gives us a sizeable presence in tour wholesaling and marks the first truly vertical integration for NWA Inc.

We continued to strengthen the management of Northwest Airlines in 1985 as John F. Horn was elected Executive Vice President-Corporate Planning and International. Also elected as a corporate officer in 1985 was Roger D. Hauge, Vice President-Atlantic Region.

Looking ahead, Northwest has positioned itself to continue growing and expanding. We believe that 1986 should be a good year for Northwest, but the greatest uncertainty that we face...along with every other carrier...is severe price competition. Given the ongoing potential for this competition in the current environment, we are continuing to stress strategies and programs that will improve our operating efficiencies and sharpen our competitive edge. Further, we expect approval of our purchase of Republic, a step which will double our domestic traffic.

As in the past, our nearly 17,000 employees deserve a special word of thanks for their outstanding efforts in 1985. We also appreciate the continuing support of our shareholders and hope to again reward your confidence in Northwest in 1986.

Sincerely,

Steven G. Rothmeier

President and Chief Executive Officer

Northwest signed $2 billion in orders in 1985 for 23 additional aircraft, including 10 new-technology Boeing 747-400 jetliners. Developed specifically for Northwest's Pacific routes, the 450-passenger 747-400 will set the standards for efficiency and passenger comfort in Far Eastern markets.

Keeping Northwest Competitive with a Modern, Growing Fleet To keep Northwest competitive in both the domestic and international marketplaces, $2 billion in orders were signed in 1985 for 23 new aircraft. The largest in Northwest's history, these orders include: • ten new-technology Boeing 747-400s for transpacific service. • ten additional Boeing 757-200s for domestic service. • three more 747-200s to be used on international routes.

To be delivered in 1986, the additional 747-200s will bring the number of Northwest 747s to 38, the largest fleet of full-sized 747s in the U.S airline industry. The 747-400s will enter service beginning in 1988, with the deliveries completed in 1990. Delivery of the newly ordered 757s will begin in 1987 and be completed by 1989, at which time Northwest will be operating 30 of these advanced aircraft.

The new aircraft will complement one another, allowing expanded and efficient operations in domestic, Pacific and Atlantic markets. In this way, Northwest is positioning itself to continue balanced geographic growth in the future.

The hallmark of this $2 billion transaction is the 747-400. Northwest is the launch customer for this new-generation jetliner, which was developed to Northwest's own requirements for use specifically on transpacific routes. The 747-400 will also be among the first aircraft powered by Pratt & Whitney's new 4000 engines.

The 747-400 is ideally suited to Northwest's Pacific needs for several reasons: • It will have a longer range than existing models and will, without payload restrictions, easily operate over the airline's longest existing nonstop routes such as New York to Tokyo or Chicago to Seoul. It also will permit expansion into new markets such as New York to Shanghai or Seoul. • The 747-400 will use 22 percent less fuel per seat mile than the 747s now in use. • It will fly 450 passengers—up from the current 400—and will have a cargo capacity of 60 tons. • The sophistication of the systems developed for the 747-400 permit it to be operated by two-pilot crews, as is the 757.

In all, the 747-400 offers an ideal combination of capabilities needed to serve Northwest's growing transpacific network. Its design efficiencies, together with Northwest's historically low operating costs, will result in an operation that will unequivocally set the economic standard for transpacific travel through the end of this century.

Fleet Schedule

Fleet as of March 1, 1986:	Owned	Leased	Total	On order
Boeing 727-100	9	–	9	–
Boeing 727-200	56	–	56	–
Boeing 747	29	–	29	3
Boeing 747-400	0	–	0	10
Boeing 747F	6	–	6	–
Boeing 757	8	5	13	17
McDonnell Douglas DC-10	19	–	19	–
Total	127	5	132	30

Establishing Northwest Orient Airlink marketing agreements with regional carriers is an important aspect of Northwest's overall domestic route system strategy. In addition to Mesaba Airlines, Northwest has signed Airlink agreements with America West Airlines, Big Sky Airlines and Fischer Bros. Aviation.

Implementing New Domestic Strategies Throughout 1985, Northwest placed its greatest emphasis on developing and enhancing the domestic route system. This undertaking was successful, as evidenced by 14 percent increases in both domestic revenue passenger-miles and capacity.

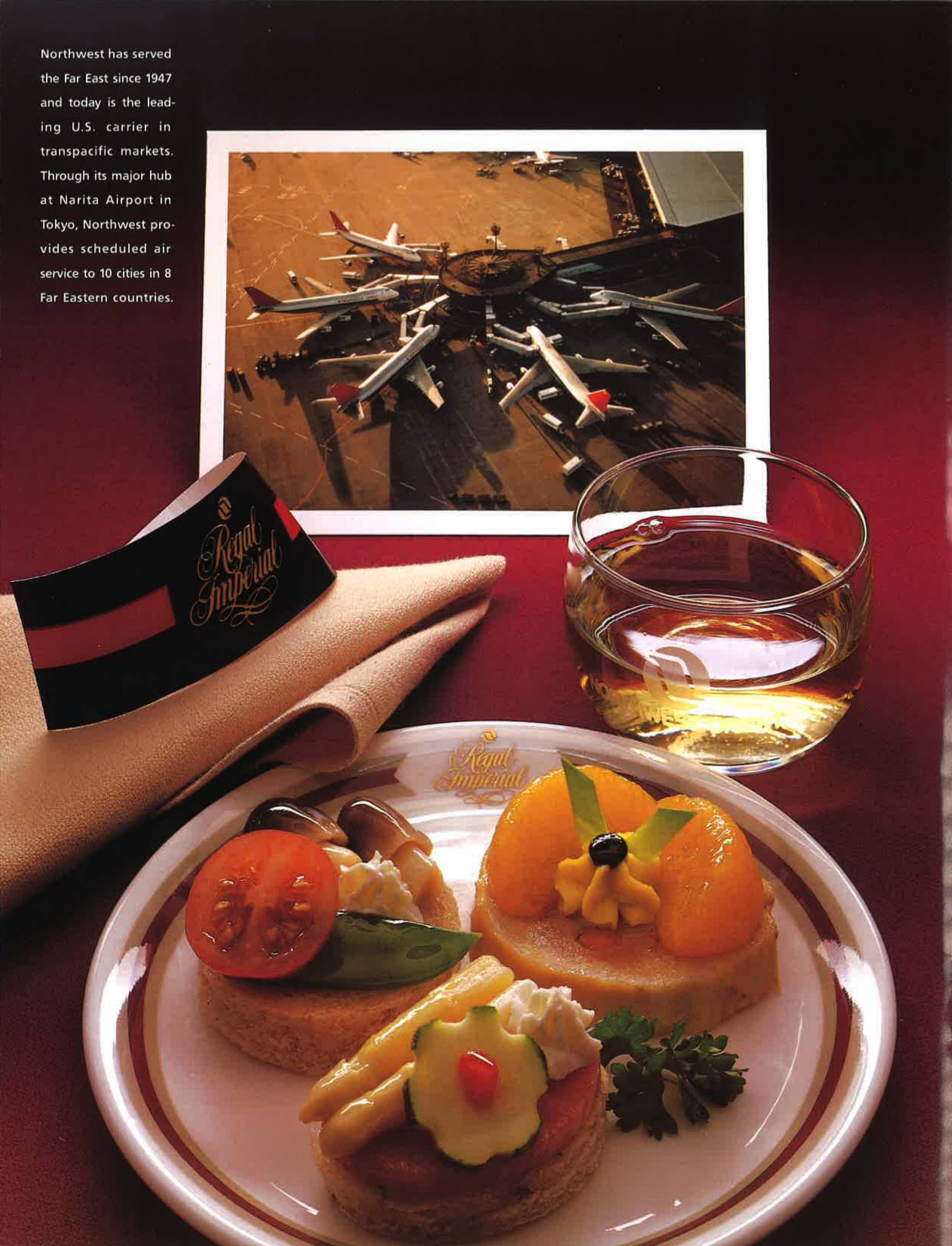
The Boeing 757 is becoming a major force in Northwest's domestic fleet. The 757 has the proper combination of range, efficiency and comfort that is needed to implement domestic expansion. The eleven 757s that Northwest was operating at year-end 1985 have met or exceeded all expectations, and Northwest will have a total of 20 757s in service by the end of 1986.

Taking full advantage of the 757s in 1985, Northwest was able to successfully execute several key strategies, including: • Dramatically increasing the level of domestic nonstop service. By year-end, the 757s were providing over 12 percent of Northwest's domestic capacity. • Re-entry into the New York-Seattle nonstop market. • Providing greater volumes of feeder traffic to Northwest's international gateways. • Developing Northwest's Detroit hub, including the introduction of nonstop service to Los Angeles and Seattle/Tacoma. • Increasing service and frequencies to sun belt destinations in Florida and the Southwest. • Inaugurating Northwest's first southern tier nonstop transcontinental service, between Los Angeles and Tampa/St. Petersburg.

Northwest Orient Airlink marketing agreements with regional and national carriers are also important elements of Northwest's domestic strategy. Following the first Airlink agreement with Mesaba Airlines of Minneapolis/St. Paul in late 1984, Northwest established three new relationships in 1985: • America West Airlines, the largest carrier serving Phoenix, with a route system of 23 cities in the Southwest and West and an all-jet fleet. • Big Sky Airlines, which serves 13 cities in Montana, Wyoming and North Dakota. • Fischer Bros. Aviation, a regional airline headquartered in Ohio that carries passengers between Detroit and seven other cities in Ohio and Michigan.

Through these Northwest Orient Airlink agreements, the route systems of the smaller carriers are tied directly into Northwest's global structure. The result is better passenger service and higher volumes of feeder traffic into hubs served by Northwest.

As part of every agreement, the flight designation of each Airlink partner carries Northwest's code in the computer reservations systems used by travel agents. In addition, Airlink agreements provide for coordinated scheduling, joint fares, participation in Northwest's Free Flight Plan, joint advertising and baggage handling arrangements.



Northwest has served the Far East since 1947 and today is the leading U.S. carrier in transpacific markets. Through its major hub at Narita Airport in Tokyo, Northwest provides scheduled air service to 10 cities in 8 Far Eastern countries.

Expanding in Pacific and Atlantic Markets Northwest further solidified its position as the leading U.S. carrier in the Pacific in 1985 by providing daily nonstop service to Tokyo from six U.S. gateway cities—New York, Chicago, Seattle, San Francisco, Los Angeles and Honolulu. The airline operated 61 weekly roundtrip nonstop flights between the U.S. and the Orient during summer 1985. This included introduction of air service to and from Kuala Lumpur, the capital city of Malaysia. Northwest's competitive position in the Pacific, as measured by the most recently available statistics, remains strong at 26.5 percent of the U.S./Japan market and nearly 19 percent of the total transpacific traffic.

Even with the full-scale entry of United Airlines into the Pacific in 1986, Northwest remains the largest U.S. carrier in this growing market. Having served the Orient since 1947 and gained the confidence of customers and shippers in the U.S. and throughout the Orient, Northwest intends to build upon its position of leadership by: • Capitalizing on an extensive intra-Asian system, currently composed of a strong Tokyo hub with spokes to nine cities throughout the Far East, and an expanded connecting complex at Seoul. • Developing steadily higher volumes of domestic feeder traffic to the six cities that serve as Northwest's U.S. gateways to the Orient. This is now being accomplished through Northwest's growing fleet of 757s and will be greatly expanded with the pending addition of Republic's domestic system. • Further increasing transpacific capacity and scheduling in 1986 with three new 747-200s. • Utilizing the new-technology, 450-passenger 747-400 aircraft beginning in 1988.

The year 1985 was also a successful period for Northwest's Atlantic operations. By late 1985, Northwest ranked sixth out of the 50 transatlantic airlines in passengers carried across the Atlantic, up from seventh in 1984. In summer 1985, the airline operated 35 transatlantic flights per week from the U.S. gateways of New York, Boston and Minneapolis/St. Paul to eight European cities.

Mainline Travel, Inc. became a wholly-owned subsidiary of NWA Inc. in 1985. A major wholesaler of tour and vacation travel packages, MLT gives NWA Inc. a significant presence in this growing industry. This acquisition also marks the first step toward vertical integration for NWA Inc.

Vertical Integration into Tour Wholesaling NWA Inc. diversified into the tour wholesale market in 1985 with the acquisition of Mainline Travel, Inc. (MLT). MLT thus became the first acquisition of NWA Inc., which was formed in 1984 as the parent company of Northwest Airlines. The holding company structure was adopted to facilitate the corporation's entry into new business ventures, and the acquisition of MLT represents the first step toward vertical integration in a related industry.

MLT is one of the nation's largest and fastest growing wholesalers of low-cost vacation travel packages and has annual revenues of approximately $100 million. It makes bulk purchases of hotel rooms and land accommodations, combines these with charter air services or low-cost seats on scheduled carriers; and sells these travel packages through retail travel agencies and directly to the public. Northwest has been a supplier to MLT in the past, providing seats on flights in selected markets. This acquisition is a good fit from the standpoint of seasonal revenue generation. The first quarter of each year is normally MLT's strongest period but is typically soft for Northwest. Consequently, the airline can readily make passenger seats available for MLT during this period. It is expected that MLT's successful tour wholesaling business will have a further positive effect on the overall results of NWA Inc. through improved traffic on Northwest.

Technical excellence in maintenance programs, weather forecasting and noise abatement are just a few of the reasons why Northwest is a pacesetter in the airline industry.

Leadership and Excellence in Technical Management Excellence in technical aspects of airline operations has always been a tradition of Northwest Airlines. The use of conservative maintenance schedules, adherence to strict quality-control policies and development of programs that have led the air carrier industry have become trademarks of Northwest. Air Transport World, a leading industry publication, selected Northwest for its Financial Management Award for 1984 and has followed this with its 1985 Technical Management Award. In making that award the publication stated, "Selection of Northwest Airlines as the recipient of Air Transport World's Technical Management Award is a recognition of one of the most effective, efficient and productive operations in the business." In addition to the award, the airline continues to be nationally recognized by industry groups and government agencies as the industry pacesetter in the following key areas: • The airline does all of its airframe maintenance, engine overhaul and virtually all accessory and component work at its own facilities with its own staff. Northwest accomplishes major aircraft maintenance on a rigid program related to hours of flight time. Performing these tasks in-house ensures a high level of quality assurance and provides for better control of maintenance costs. • Northwest has maintained its own meteorology department at a time when many airlines are reducing or eliminating weather departments. Northwest's meteorology department developed turbulence plot and weather forecasting programs that are reliable in identifying potentially dangerous weather situations and getting this information in a matter of minutes to pilots while in flight. • Northwest pioneered procedures for quieting jet noise over the communities it serves. Its noise abatement procedures have been adopted throughout the airline industry, and Northwest's pilots are frequently recognized for their strict adherence to this good neighbor policy.

Northwest has learned that, in addition to obvious safety advantages, superior technical management improves bottom-line results. Its conservative maintenance schedules and strict adherence to noise abatement procedures are reasons why its aircraft burn less fuel than similar types flown by other airlines. Northwest's operating expenses also rank consistently among the lowest in the industry. These benefits transfer directly to the customer in terms of reliable on-time performance, which is one of the best ways to ensure repeat customers.

In 1985 Northwest completed a 54,000-square-foot addition to its Main Base facility, which houses equipment and personnel necessary to overhaul Pratt & Whitney 2037 jet engines that power the new 757 aircraft. Further, the Northwest engine test cell has been modified to accommodate checks and calibrations required for each 2037 after overhaul and before installation on an aircraft.

The Decision to Acquire Republic Airlines The planned $884 million acquisition of Republic Airlines by NWA Inc. represents a logical and positive development from practically any business standpoint. Through this proposed combination of two medium-sized carriers with complementary route systems and fleets, Northwest will gain the economic mass neccessary to compete more effectively and efficiently in this intensely competitive industry. When this transaction is approved by Republic's shareholders and the federal government—as it is expected to be—the new Northwest will be the nation's third largest carrier in terms of revenue passenger-miles. Northwest will operate more than 300 aircraft, employ over 30,000 people and serve more than 130 cities worldwide.

The rapid expansion of carriers such as American and United since the beginning of airline deregulation has resulted in these airlines becoming "mega-carriers." To compete effectively against these carriers over the long term, Northwest needs a domestic system of a certain threshold size. Northwest was building toward this critical mass by expanding internally, but it became apparent that a more rapid expansion was needed to achieve a stronger market presence.

Northwest has historically had one major domestic hub, located at Minneapolis/St. Paul. Republic, in addition to serving the Twin Cities, also has developed significant hub and spoke systems at Detroit and Memphis. By combining the operations of the two airlines, Northwest will become the largest carrier at these three major airports and will greatly increase domestic on-line traffic.

The strong domestic system resulting from a Republic/Northwest combination will allow Northwest to greatly expand the feeder traffic to the airline's eight international gateways. This will enable Northwest to offer more single-carrier service to the Orient and Europe. In short, acquiring Republic will permit Northwest to attain a key objective in today's highly competitive environment: to keep passengers flying on a single airline—in this case Northwest—for all or most of their trips.

Northwest's and Republic's fleets are excellent matches in terms of operational capabilities. Republic's smaller aircraft, which average 102 seats, are ideal for building and serving domestic hub and spoke systems. Northwest's larger aircraft, averaging 228 seats, are well suited for longer hauls, including transcontinental and international service. The combined fleet will facilitate further development of a strong domestic system linking most areas of the United States with both the Orient and Europe.

As part of an approved plan of reorganization, Northwest Airlines, Inc. (Northwest) became a wholly-owned subsidiary of NWA Inc. (NWA) in the latter part of 1984. The creation of NWA as a holding company did not result in any changes in the operation of Northwest and the shareholders of Northwest automatically became shareholders of NWA.

In October, 1985 NWA purchased 100% of the capital stock of Mainline Travel, Inc. (MLT). MLT is a major wholesaler of low-cost vacation travel packages.

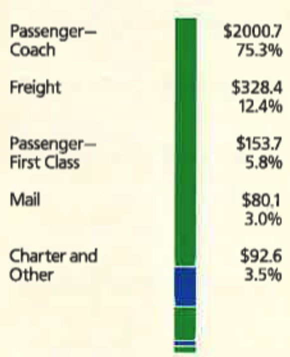
Northwest and MLT are the only operating subsidiaries of NWA and together are responsible for all of its operating revenues and substantially all of its operating expenses.

Earnings and Dividends NWA's 1985 consolidated net earnings totaled $73,119,000 ($3.18 per share) and compare with net earnings of $55,964,000 ($2.44 per share) in 1984 and $50,073,000 ($2.19 per share) in 1983. The 1984 earnings were after an extraordinary charge of $30,903,000 resulting from the settlement of a 15-year-old lawsuit.

Operating revenues increased 8.6% to $2,655,491,000 during 1985 while operating expenses grew 9.8% to $2,578,404,000 resulting in operating income of $77,087,000 compared to $96,276,000 in 1984. 1983 operating income was $68,886,000.

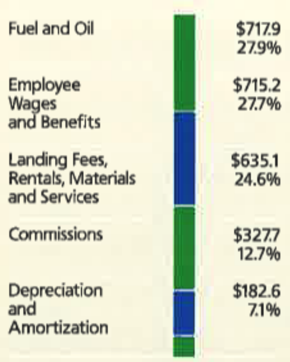
Sources of 1985 Operating Revenues

(Millions of Dollars)



Distribution of 1985 Operating Expenses

(Millions of Dollars)



Interest expense totaled $19,873,000 in 1985 compared with $4,268,000 and $3,548,000 in 1984 and 1983, respectively. The additional interest expense in the current year is a result of the higher level of debt outstanding for much of the year and the capital lease obligations entered into during the fourth quarter.

Investment income totaled $4,741,000 in 1985, $7,214,000 in 1984 and $7,960,000 in 1983. Gain from the disposal of property amounted to $2,780,000 in 1985 and compares with $19,864,000 in 1984 and $805,000 in 1983. The 1984 gain reflected the sale of three McDonnell Douglas DC-10-40 aircraft.

Earnings before income taxes for 1985 were $64,743,000 compared to $117,388,000 in 1984 and $73,603,000 in 1983.

In 1985 NWA paid dividends to shareholders totaling $19,586,000 (90¢ per share) continuing an unbroken string of cash dividends extending back 123 consecutive quarters.

NWA common stock is principally traded on the New York Stock Exchange. A table showing sales prices and dividends paid per share in 1985 and 1984 is included on page 33.

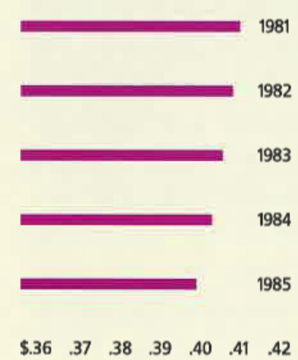
Operating Revenues Operating revenues increased 8.6% in 1985 to $2,655,491,000 compared with $2,444,974,000 in 1984 and $2,196,036,000 in 1983. Passenger revenues for 1985 rose 8.5% to $2,154,394,000, the result of a 13.0% increase in revenue passenger-miles and a 4.0% decrease in yield (revenue per passenger-mile). 1984 passenger revenues of $1,984,999,000 were 9.5% greater than 1983 due to an 11.6% increase in traffic and a 1.9% decline in yield.

The current year 13.0% increase in revenue passenger-miles compares with an aggressive 13.7% increase in capacity (available seat-miles), resulting in a slight drop in passenger load factor to 60.1% from 60.5% in 1984. Load factor in 1983 was 60.0%. The actual passenger load factors compare to break-even passenger load factors of 58.0% in 1985, 57.6% in 1984 and 57.7% in 1983.

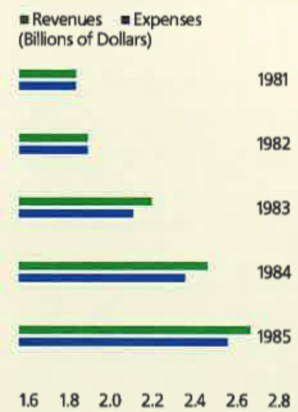
Freight revenues declined 7.6% to $328,400,000 in 1985 due to an 8.2% decrease in freight ton-miles and a .7% increase in yield per ton-mile. 1984 freight revenues totaled $355,336,000 and were 22.9% greater than 1983. Mail revenues increased 37.3% to $80,126,000 in 1985 and compare with $58,339,000 in 1984 and $55,585,000 in 1983.

Charter and other transportation revenues increased 45.1% to $55,959,000 in 1985, primarily due to a higher level of military charter activity. Charter and other transportation revenues totaled $38,559,000 in 1984 and $36,198,000 in 1983.

Operating Costs per Available Ton-Mile



Operating Revenues and Expenses



Other revenues totaled $36,612,000 in 1985, $7,741,000 in 1984 and $2,856,000 in 1983. Revenues of MLT subsequent to its purchase by NWA are included in other revenues.

Operating Expenses Operating expenses for 1985 totaled $2,578,404,000, a 9.8% increase over the prior year. 1984 operating expenses were $2,348,698,000, up 10.4% over 1983 expenses of $2,127,150,000. For the fourth year in a row, capacity of the airline increased at a greater rate than airline operating expenses. As a result, operating expenses per available ton-mile decreased to 39.8¢ in 1985 from 40.2¢ in 1984 and 40.5¢ in 1983.

Aircraft fuel expense increased a modest 3.7% in 1985 to $717,870,000 despite an 11.6% increase in plane-miles flown. This is a reflection of the continuing decline in jet fuel prices, which averaged 83.07¢ in 1985, 87.76¢ in 1984 and 92.58¢ in 1983. Additional fuel price declines are expected during 1986.

Salaries and related costs increased 11.8% to $715,172,000 over 1984, the result of a higher level of employment, wage increases during the year and increased payroll taxes. Agency commission expenses increased 7.2% to $327,708,000 in 1985, reflecting the higher level of passenger revenues earned. Rentals and landing fees increased 8.3% to $106,220,000 and aircraft maintenance materials and repairs remained virtually flat at $111,742,000.

Depreciation and amortization expense increased 9.2% in 1985 to $182,563,000 compared with $167,203,000 in 1984 and $146,908,000 in 1983. The 1985 increase is primarily the result of the addition of eleven new 757-200 passenger aircraft while the 1984 increase reflects the addition of five additional 747s.

Other operating expenses increased $83,026,000 over 1984, primarily the result of higher marketing and passenger service expenses plus the inclusion of MLT expenses for part of the year.

Pension costs for 1985 were determined in accordance with Accounting Principles Board Opinion No. 8. The Company has not yet determined the impact on pension costs of the recently issued FASB Statement No. 87, which must be adopted by 1987. The impact and effect of inflation and changing prices are discussed in footnote K to the financial statements.

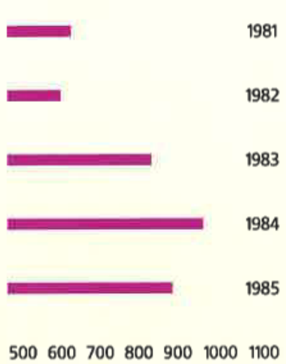
Taxes On Earnings Income taxes were a credit of $8,376,000 in 1985 compared to an expense of $2,427,000 in 1984 (after the $28,094,000 income tax credit resulting from the extraordinary item) and $23,530,000 in 1983. Earned investment tax credits totaled $37,749,000 in 1985, $23,576,000 in 1984 and $9,745,000 in 1983. Investment tax credits are applied on tax returns as allowed by income tax regulations. Credits not currently applied are offset against deferred taxes for accounting purposes, and as of December 31, 1985, these credits totaled $75,395,000.

Financial Condition Stockholders' equity at December 31, 1985, totaled $947,001,000 or $43.49 per share, up $54,078,000 or $2.44 per share from the balance at December 31, 1984.

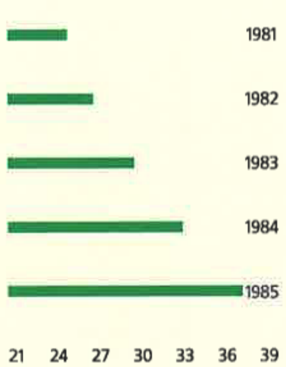
Long-term debt, excluding current maturities, totaled $332,992,000 at December 31, 1985, and long-term obligations under capital leases were $161,101,000. Thus, capitalization consisted of 34% long-term debt (including lease obligations) and 66% equity.

During the fourth quarter 1985, Northwest leased five 757-200 passenger aircraft under the commonly called "finance lease" provisions of the tax code. Northwest was the first airline to use this new type of lease, which provides for the ability to have a low fixed price purchase option at the end of the lease term, for commercial jetliners.

Scheduled Freight Ton-Miles
(Millions)



Scheduled Available Seat-Miles
(Billions)



For accounting purposes these leases are treated as capital leases while for tax purposes they are treated as operating leases. All other aircraft are owned outright by Northwest and none have been pledged as security for debt or otherwise encumbered.

In addition to providing the majority of NWA's $73 million profit during 1985, and thus continuing an unbroken string of profitability going back to 1950, Northwest also lowered its unit costs, achieved above average growth in revenue passenger-miles and, for the seventh consecutive year, increased its market share.

Cash Flow, Liquidity and Capital Resources Cash provided from operations during 1985 totaled $221,432,000 compared with $215,413,000 in 1984 and $209,865,000 in 1983. Total cash from all sources including borrowings was $850,343,000 in 1985, $281,100,000 in 1984 and $383,818,000 in 1983. During 1985 the Company issued $236,988,000 of new debt, including $175,000,000 of 7½% convertible subordinated debentures due in 2010, increased the amount of outstanding commercial paper by $134,357,000 and entered into $167,290,000 of capital lease obligations. No borrowings have been made under the available bank revolving credit agreement. Total cash used during 1985 was $854,065,000 compared with $333,222,000 in 1984 and $314,632,000 in 1983.

The major uses of cash during the year were equipment purchases of $432,698,000 and aircraft deposits of $260,418,000. Eleven new Boeing 757-200 passenger aircraft were placed into service during 1985 with nineteen more scheduled for delivery in 1986 through 1989. Other aircraft purchase commitments consist of three Boeing 747-200 passenger aircraft to be delivered in 1986 and ten new-generation Boeing 747-400 passenger aircraft which will be delivered in 1988, 1989 and 1990. Outstanding aircraft purchase commitments were approximately $1,923,163,000 at December 31, 1985, including approximately $524,868,000 for expenditures in 1986. In addition, deposits totaling $239,292,000 have been made with manufacturers in connection with the above aircraft orders. The Company expects to finance its aircraft purchase commitments with a combination of leases, new debt and internally generated funds.

On January 23, 1986, NWA entered into an agreement to purchase Republic Airlines, Inc. for approximately $884,000,000. Republic is a major U.S. air carrier serving approximately 100 cities in 34 states, Canada, Mexico and the Cayman Islands. The proposed transaction is subject to government and Republic shareholder approval. The Company expects to incur additional debt to facilitate its acquisition of Republic.

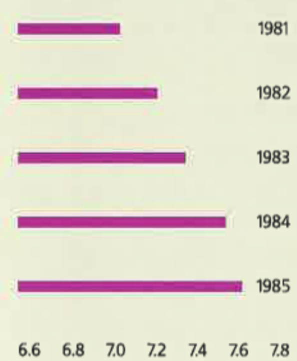
At December 31, 1985, NWA and its subsidiaries had cash and short-term investments of $45,842,000 compared to $49,564,000 in 1984 and $101,686,000 in 1983. In addition, it has a revolving credit agreement with a group of major banks which provides for unsecured borrowings up to $500,000,000 through June 30, 1988. The Company believes that internally generated funds plus borrowings will provide sufficient capital to meet all present commitments.

Selected Financial Data (In Thousands Except Per Share Amounts)

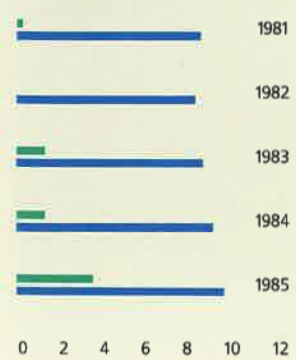
Year Ended December 31	1985	1984	1983	1982*	1981
Operating Revenues	**$2,655,491**	$2,444,974	$2,196,036	$1,877,568	$1,854,290
Net Earnings	**73,119**	55,964**	50,073	5,019	10,460
Total Assets	**2,320,006**	1,754,233	1,602,236	1,377,387	1,492,381
Long-Term Debt	**332,992**	100,000	100,000	—	12,500
Obligations Under Capital Leases	**161,101**	—	—	—	—
Per Common Share:					
Earnings	**3.18**	2.44**	2.19	.23	.48
Cash Dividends	**.90**	.825	.80	.80	.80

*Operating results were affected by a major strike which extended from May 22, 1982 to June 17, 1982.
**After extraordinary charge of $30,903 or $1.30 per share resulting from the settlement of a lawsuit.

Fuel Efficiency Increases
(Available ton-miles per gallon)



Stockholders' Equity vs. Long-Term Debt
(Hundred Millions of Dollars)
■ Debt ■ Equity



Consolidated Statements of Financial Position NWA Inc.

(Dollars in Thousands)

December 31	1985	1984
ASSETS		
Current Assets		
Cash and short-term investments	$ 45,842	$ 49,564
Accounts receivable, less allowance of $2,300 (1984—$2,150)	248,794	196,836
Flight equipment spare parts, less allowance for depreciation of $40,230 (1984—$35,490)	52,955	52,464
Maintenance and operating supplies	22,985	19,682
Prepaid expenses	22,311	25,190
Prepaid income taxes	—	23,914
TOTAL CURRENT ASSETS	392,887	367,650
Other Assets	43,437	18,491
Property and Equipment		
Flight equipment	2,617,263	2,356,048
Less accumulated depreciation	1,356,033	1,204,118
	1,261,230	1,151,930
Advance payments on new flight equipment	239,292	57,795
Other property and equipment	365,769	287,391
Less accumulated depreciation	148,493	129,024
	217,276	158,367
Property and Equipment Under Capital Leases—Note F		
Flight equipment	167,290	—
Less accumulated depreciation	1,406	—
	165,884	—
	1,883,682	1,368,092
	$2,320,006	$1,754,233

December 31	1985	1984
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Commercial paper	$ 152,191	$ 17,834
Accounts payable and other liabilities	262,805	230,944
Employee compensation	59,936	114,789
Air traffic liability	131,912	103,900
Income tax	110	—
Current maturities of long-term debt	3,996	—
Current obligations under capital leases	6,189	—
TOTAL CURRENT LIABILITIES	617,139	467,467
Long-Term Debt—Note C	332,992	100,000
Long-Term Obligations Under Capital Leases—Note F	161,101	—
Deferred Credits and Other Liabilities		
Income taxes—Note E	246,213	280,463
Other	15,560	13,380
	261,773	293,843
Stockholders' Equity—Note D		
Common Stock $2.00 par value, authorized 60,000,000 shares; issued and outstanding, 1985—21,774,251 shares; 1984—21,749,667 shares	43,549	43,499
Capital surplus	111,318	110,823
Retained earnings	792,134	738,601
	947,001	892,923
Commitments and Contingencies—Notes F and G		
	$2,320,006	$ 1,754,233

See notes to consolidated financial statements.

Consolidated Statements of Earnings NWA Inc.
(Dollars in Thousands, except per share amounts)

Year Ended December 31	1985	1984	1983
Operating Revenues			
Passenger	$2,154,394	$1,984,999	$1,812,227
Freight	328,400	355,336	289,170
Mail	80,126	58,339	55,585
Charter and other transportation	55,959	38,559	36,198
Other	36,612	7,741	2,856
	2,655,491	2,444,974	2,196,036
Operating Expenses			
Fuel, oil and taxes	717,870	692,160	672,169
Salaries and related	715,172	639,606	569,535
Commissions	327,708	305,679	251,943
Rentals and landing fees	106,220	98,044	89,651
Aircraft maintenance materials and repairs	111,742	111,903	100,483
Other operating	417,129	334,103	296,461
Depreciation and amortization	182,563	167,203	146,908
	2,578,404	2,348,698	2,127,150
OPERATING INCOME (LOSS)	77,087	96,276	68,886
Other Income (Expenses)			
Investment income	4,741	7,214	7,960
Interest, net of capitalized interest (1985—$7,799; 1984—$5,446; 1983—$4,872)	(19,873)	(4,268)	(3,548)
Gain on sale of equipment	2,780	19,864	805
Other	8	(1,698)	(500)
	(12,344)	21,112	4,717
Earnings Before Income Taxes and Extraordinary Item	64,743	117,388	73,603
Income tax expense (credit)—Note D	(8,376)	30,521	23,530
EARNINGS BEFORE EXTRAORDINARY ITEM	73,119	86,867	50,073
Extraordinary loss from settlement of litigation (less applicable income tax credit of $28,094)—Note F	—	(30,903)	—
NET EARNINGS	$ 73,119	$ 55,964	$ 50,073
Earnings Per Share—Primary and Fully Diluted			
Earnings before extraordinary item	$ 3.18	$ 3.74	$ 2.19
Extraordinary loss	—	(1.30)	—
NET EARNINGS PER SHARE	$ 3.18	$ 2.44	$ 2.19

See notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position NWA Inc.
(Dollars in Thousands)

Year Ended December 31	1985	1984	1983
Cash Provided			
Earnings before extraordinary item	$ 73,119	$ 86,867	$ 50,073
Add (deduct) non-cash items:			
Depreciation and amortization	182,563	167,203	146,908
Increase (decrease) in deferred income taxes	(34,250)	20,340	12,884
TOTAL FROM OPERATIONS BEFORE EXTRAORDINARY ITEM	221,432	274,410	209,865
Extraordinary loss before tax benefit of $28,094	—	(58,997)	—
TOTAL FROM OPERATIONS	221,432	215,413	209,865
Issuance of debt	236,988	—	100,000
Increase in capital lease obligations	167,290	—	—
Increase (decrease) in commercial paper	134,357	17,834	(4,958)
Increase in accounts payable and other liabilities	31,861	16,282	41,305
Increase (decrease) in air traffic liability	28,012	(1,033)	27,728
Net book value of property dispositions	775	20,672	2,667
Other	29,628	11,932	7,211
TOTAL CASH PROVIDED	850,343	281,100	383,818
Cash Used			
Additions to flight equipment, other property and deposits	693,116	345,844	234,256
Decrease (increase) in accrued employee compensation	54,853	(63,926)	(10,847)
Increase in accounts receivable	51,958	7,171	46,018
Dividends	19,586	17,933	17,367
Other	34,552	26,200	27,838
TOTAL CASH USED	854,065	333,222	314,632
INCREASE (DECREASE) IN CASH AND SHORT-TERM INVESTMENTS	(3,722)	(52,122)	69,186
Cash and short-term investments at the beginning of the year	49,564	101,686	32,500
Cash and short-term investments at the end of the year	$ 45,842	$ 49,564	$101,686

See notes to consolidated financial statements.

(In Thousands Except Per Share Amounts)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings
Balance January 1, 1983	21,678	$27,098	$125,643	$667,864
Exercise of stock options	38	47	831	–
Net earnings for 1983	–	–	–	50,073
Cash dividends—$.80 per share	–	–	–	(17,367)
Balance December 31, 1983	21,716	27,145	126,474	700,570
Exercise of stock options	38	55	840	–
Increase in par value from $1.25 to $2.00 per share	–	16,308	(16,308)	–
Net earnings for 1984	–	–	–	55,964
Cash dividends—$.825 per share	–	–	–	(17,933)
Other	(4)	(9)	(183)	–
Balance December 31, 1984	21,750	43,499	110,823	738,601
Exercise of stock options	30	60	753	–
Net earnings for 1985	–	–	–	73,119
Cash dividends—$.90 per share	–	–	–	(19,586)
Other	(6)	(10)	(258)	–
Balance December 31, 1985	21,774	$43,549	$111,318	$792,134

See notes to consolidated financial statements.

Note A—Accounting Policies A summary of significant accounting policies of the Company is set forth below:

Basis of Presentation: The consolidated financial statements include the accounts of NWA Inc., Northwest Airlines, Inc., and all other subsidiaries after elimination of intercompany accounts and transactions.

Short-Term Investments: Short-term investments are stated at cost which approximates market and amounted to $16,528,000 and $30,173,000 at December 31, 1985 and 1984, respectively.

Flight Equipment and Property: Provision for depreciation is computed by the straight line method over the estimated useful lives of the assets. Useful lives are estimated at fifteen years with 10% residual values for 747, DC-10, and 757 aircraft and ten years with 15% residual value for 727 aircraft. Useful lives of buildings vary from 5-30 years and other equipment from 4-10 years. Depreciation of flight equipment spare parts, rotables and assemblies is provided by the straight line method at rates which depreciate cost, less residual value, over the estimated useful lives of the related aircraft.

Pension Plans: The Company has several noncontributory pension plans covering substantially all of its employees. The pension costs accrued include amortization of prior service costs over periods of ten to thirty years. It is the Company's policy to annually fund at least the minimum pension contribution as required by the Employees Retirement Income Security Act.

Income Taxes: Income taxes are provided at statutory rates applied to earnings before income taxes regardless of when such taxes are paid. Deferred income taxes arise principally from timing differences between financial and tax methods of accounting for depreciation and capitalized interest.

The Company uses the flow-through method of accounting for investment tax credits. Investment tax credits not applied on tax returns are offset against deferred income taxes to the extent they are applicable to deferred taxes becoming payable in the investment tax credit carryover periods.

Operating Revenues: Passenger and freight revenues are recognized when the transportation is provided.

Earnings Per Share: Net earnings per share are calculated by dividing net earnings, adjusted for interest expense (net of income taxes) on the convertible debentures, by the weighted average number of shares of Common Stock and Common Stock equivalents. Common Stock equivalents consist of convertible debentures and stock options.

Reclassifications: Certain amounts in the 1984 and 1983 financial statements have been reclassified to conform with the 1985 presentation.

Note B—Business Acquisition Effective October 1, 1985, the Company acquired 100% of the capital stock of Mainline Travel, Inc., a wholesaler of vacation travel packages. The transaction, which is not material to the Company's financial results, was accounted for as a purchase.

On January 23, 1986, the Company entered into an agreement to purchase Republic Airlines, Inc. for $884 million. Republic is a major U.S. air carrier serving approximately 100 cities in 34 states, Canada, Mexico and the Cayman Islands. The proposed transaction is subject to government and Republic shareholder approval.

Note C—Long-Term Debt and Credit Arrangements Long-term debt less current maturities consists of (in thousands):

	1985	1984
9% senior notes due 1992	$ 50,000	$ –
10⅛% notes due 1988	7,992	–
Convertible subordinated debentures:		
7½% due 2007	100,000	100,000
7½% due 2010	175,000	–
	$332,992	$100,000

The Company has a revolving credit agreement with a group of major banks which provides for unsecured borrowings up to $500 million through June 30, 1988. This amount decreases periodically thereafter to the termination date of July 1, 1994. Interest on borrowings is, at the Company's election, the lower of various formula rates or the prime rate as defined until June 30, 1991, and the formula rate or prime rate plus 1/4% thereafter. Commitment fees ranged from 1/16% to 1/8% per annum on the unused credit and amounted to $469,000 in 1985. During 1985 there were no borrowings under the revolving credit agreement.

In February 1983 the Company issued $100 million of 7½% convertible subordinated debentures due in 2007. The debentures are convertible into Common Stock at a rate of $50.75 per share. The debentures are redeemable at prices ranging from 106% in 1986 to 100% in 2002 of the principal amount. Annual sinking fund payments are required beginning in 1992 of $5 million, less the amount of debentures converted or redeemed.

In June 1985 the Company issued $175 million of 7½% convertible debentures due in 2010. The debentures are convertible into Common Stock at a rate of $57.00 per share. Subject to certain restrictions, the Company may redeem the debentures at prices ranging from 107% in 1986 to 100% in 2005 of the principal amount. Annual sinking fund payments are required beginning in 1995 of $7.5 million, less the amount of debentures converted or redeemed.

The Company was in compliance with the covenants of all debt agreements at the end of the year. At December 31, 1985, approximately $214,000,000 of retained earnings was available for the payment of dividends under the terms of the agreements.

Note D—Stockholders' Equity

	Shares	
	1985	1984
Cumulative Preferred Stock:		
Authorized	5,000,000	5,000,000
Issued	None	None

The Company has 5,040,618 shares of Common Stock reserved for conversion of the 7½% convertible subordinated debentures as of December 31, 1985.

Common Stock options at prices which were not less than 100% of market at date of grant are as follows:

	Shares	Price Per Share
Outstanding at January 1, 1984	94,442	$23.31
Granted	126,650	44.06
Exercised	(38,395)	23.31
Lapsed	(2,750)	23.31/44.06
Outstanding at December 31, 1984	179,947	23.31/44.06
Granted	158,000	42.19
Exercised	(29,710)	23.31/44.06
Lapsed	(10,500)	44.06/42.19
Outstanding at December 31, 1985	297,737	23.31/44.06/42.19
Options exercisable:		
At December 31, 1984	54,797	23.31
At December 31, 1985	86,663	23.31/44.06

Shares available for stock option plans were 197,000 and 350,000 at December 31, 1985 and 1984, respectively.

Note E—Taxes on Earnings (Dollars in thousands) Reconciliation of the Company's effective income tax rate is as follows:

	Year ended December 31		
	1985	1984	1983
Statutory rate applied to earnings before tax and extraordinary item	$29,782	$53,998	$33,857
Add (deduct):			
Investment tax credit earned	(37,749)	(23,576)	(9,745)
Rate change on timing differences	(1,444)	(1,467)	(1,284)
Other	1,035	1,566	702
Income tax expense (credit) before extraordinary item	(8,376)	30,521	23,530
Tax benefit on extraordinary loss	–	(28,094)	–
Total income tax expense (credit)	$ (8,376)	$ 2,427	$23,530

Note E—Taxes on Earnings (Dollars in thousands)—Continued

Federal, foreign and state income taxes (credit) consist of the following:

	1985		1984		1983	
	Current	Deferred	Current	Deferred	Current	Deferred
Federal	$(6,039)	$(6,061)	$ 6,687	$(7,107)	$6,396	$14,138
Foreign	1,855	–	1,118	–	827	–
State	(868)	2,737	2,889	(1,160)	2,068	101
	$(5,052)	$(3,324)	$10,694	$(8,267)	$9,291	$14,239

The deferred income tax expense (credit) consists of the following:

	1985	1984	1983
Extraordinary loss	$28,094	$(28,094)	$ –
Accelerated depreciation	13,739	(3,566)	(10,961)
Investment tax and other credits	(54,891)	15,958	24,123
Disposition of property	(565)	8,749	–
Interest	3,588	2,505	2,241
Deferred employee benefits	(923)	(834)	(685)
Deferred 757 training costs	4,346	–	–
Deferred revenue	2,220	–	–
Rate change on timing differences	(1,444)	(1,467)	(1,284)
Other	2,512	(1,518)	805
	$ (3,324)	$(8,267)	$14,239

Investment tax credits of $75,395,000 not applied on tax returns but offset against deferred income taxes at December 31, 1985, will expire $1,107,000 in 1996; $3,198,000 in 1997; $9,752,000 in 1998; $23,589,000 in 1999 and $37,749,000 in 2000.

Note F—Commitments At December 31, 1985, the Company has contracted to purchase nineteen 757-200 aircraft for delivery in 1986 through 1989, three Boeing 747-200 aircraft for delivery in 1986 and ten Boeing 747-400 aircraft for delivery in 1988 through 1990. Deposits of $239,292,000 have been made with the manufacturers, and additional expenditures for these aircraft and related equipment will be approximately: 1986—$524,868,000; 1987—$271,840,000; 1988—$413,756,000; 1989—$430,806,000; and 1990—$281,893,000.

The Company leases space in air terminals, land and buildings at airports and ticket, sales and reservation offices under noncancelable operating leases which expire in various years through 2018. Portions of these facilities are subleased under noncancelable operating leases expiring in various years through 1995. The Company also leases certain aircraft under capital leases which expire in 2003.

Rental expense for all operating leases consisted of:

	1985	1984	1983
Gross	$44,330,000	$39,884,000	$35,633,000
Sublease rental income	(1,818,000)	(1,079,000)	(1,099,000)
	$42,512,000	$38,805,000	$34,534,000

Future minimum rental commitments at December 31, 1985, for noncancelable operating leases with initial or remaining terms of one year or more, of which $470 million are for air terminal and airport facilities and future minimum rental commitments for capital leases are as follows:

	Capital Leases	Operating Leases
1986	$ 16,501,000	$ 31,107,000
1987	16,981,000	29,983,000
1988	16,981,000	27,453,000
1989	17,619,000	23,182,000
1990	15,894,000	21,706,000
Thereafter	214,886,000	345,189,000
	298,862,000	478,620,000
Less sublease rental income		8,610,000
Less amounts representing interest	131,572,000	
Present value of obligations under capital leases and minimum rental commitments	$167,290,000	$470,010,000

Note G—Litigation and Contingencies As previously reported, in 1973 a federal trial court in Washington, D.C., held in a class action by certain female flight attendants that the Company violated certain provisions of the Equal Pay Act of 1963 and the Civil Rights Act of 1964. After several appeals the trial court judgment was affirmed. On January 14, 1985, the Supreme Court of the United States declined to review the case.

The Company's liability was estimated at $58,997,000 including plaintiffs' attorneys' fees. This amount was reflected as an extraordinary loss in the fourth quarter of 1984 in the amount of $30,903,000 net of a $28,094,000 tax benefit.

The Company is also involved in other legal actions relating to environmental issues (primarily noise and air pollution), alleged employee discrimination, and other matters relating to the Company's business. While the Company is unable to predict the ultimate outcome of these actions, it is the opinion of management that their disposition will not have a material adverse effect on the Company's financial position.

Note H-Pension Plans The Company's pension expense was $23,242,000 in 1985, $26,409,000 in 1984 and $27,817,000 in 1983.

Certain actuarial assumptions for all plans and the actuarial cost method for one plan were changed in 1985 which reduced pension expense for the year by approximately $10,200,000. The change in actuarial method, which comprised approximately $3,800,000 of the expense reduction, was from the aggregate cost method to the projected unit credit method. The new actuarial method is believed to be preferable because it more closely matches pension expense with the pension benefits actually earned during the period and because it more accurately reflects the current funded status of the plan. The changes had no effect on pension benefits to employees.

Accumulated plan benefit information, as estimated by consulting actuaries, and plan net assets for the Company's plans are:

Year Ended December 31	1985	1984
Actuarial present value of accumulated plan benefits:		
Vested	$455,014,000	$421,624,000
Non-vested	58,363,000	51,721,000
	$513,377,000	$473,345,000
Net assets available for benefits	$735,610,000	$591,881,000

The interest rate used in computing the present value of accumulated plan benefits was 8% except for certain retired plan participants where a 13.75% rate was used. The rate for retirees is based upon the actual earnings of a dedicated securities portfolio established for the payment of their benefits.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for certain retired employees. Those benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. The cost of providing those benefits, which is not material, is recognized by expensing the annual insurance premiums.

Note I—Sales to Customers in Foreign Countries The operations of NWA Inc. consist primarily of holding stock in Northwest Airlines, Inc. Northwest Airlines, Inc. is a scheduled air carrier engaged in commercial transportation of passengers, freight and mail. Sales to customers in foreign countries were $658,000,000 in 1985, $649,000,000 in 1984 and $612,000,000 in 1983, principally associated with countries in Asia and Europe.

Note J—Quarterly Results of Operations (Unaudited) The following is a tabulation of the unaudited quarterly results of operations for the two years ended December 31, 1985:

(Dollars in Thousands)

	Operating Revenues	Operating Expenses	Earnings (Loss) Before Extraordinary Item	Net Earnings (Loss)	Earnings (Loss) Per Share of Common Stock Before Extraordinary Item	Net Earnings (Loss) Per Share of Common Stock
1985						
First quarter	$ 577,191	$ 590,793	$ 798	$ 798	$ .04	$ .04
Second quarter	692,530	638,229	35,318	35,318	1.52	1.52
Third quarter	754,535	692,561	39,012	39,012	1.55	1.55
Fourth quarter	631,235	656,821	(2,009)	(2,009)	(.09)	(.09)
	$2,655,491	$2,578,404	$73,119	$73,119	$3.18	$3.18
1984						
First quarter	$ 542,529	$ 556,123	$ 1,040	$ 1,040	$ .05	$ .05
Second quarter	622,766	578,511	39,625	39,625	1.70	1.70
Third quarter	705,251	629,450	45,898	45,898	1.97	1.97
Fourth quarter	574,428	584,614	304	(30,599)	.02	(1.28)
	$2,444,974	$2,348,698	$86,867	$55,964	$3.74	$2.44

See also Note G for extraordinary loss recorded in fourth quarter 1984.

Note K—Supplemental Information on the Effects of Changing Prices (Unaudited) AS REQUIRED BY FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) STATEMENT NO. 33, "FINANCIAL REPORTING AND CHANGING PRICES," THE COMPANY MUST PROVIDE SUPPLEMENTAL INFORMATION CONCERNING THE EFFECT OF CHANGING PRICES ON ITS FINANCIAL STATEMENTS. While there is presently no consensus on how the impact of inflation should be reported, FASB has devised an experiment requiring certain large, publicly held companies to present supplemental information reflecting the effect of specific price changes in the individual resources used by the Company and the effect of general inflation on monetary assets and liabilities. THE COMPANY HAS SERIOUS RESERVATIONS ABOUT THE USEFULNESS OF THIS DATA.

Statement of Earnings Adjusted for Changing Prices

Year Ended December 31, 1985 (Dollars in Thousands)	As Reported in the Primary Statements	Adjusted for Changes in Specific Prices (Current Costs)
Operating revenues	$2,655,491	$2,655,491
Depreciation and amortization	182,563	247,347
Other operating expenses	2,395,841	2,395,841
Gain on sale of equipment	2,780	—
Other income, net	(15,124)	(15,124)
Earnings (loss) before income taxes	64,743	(2,821)
Income tax benefit	8,376	8,376
Net earnings	$ 73,119	$ 5,555

Other Information

(Dollars in Thousands)	Adjusted for Changes in Specific Prices (Current Costs)
Purchasing power gain from holding net monetary liabilities during the year	$ 27,772
Increase in specific prices (current costs) of property and equipment held during the year*	461,897
Less effect of increase in general price level	367,706
Excess of increase in specific prices over increases in the general price level	$ 94,191

*At December 31, 1985, current cost of property and equipment, net of accumulated depreciation, was $3,055,264,000 (historical amount—$1,883,682,000).

Note K—Supplemental Information on the Effects of Changing Prices (Unaudited)—Continued

Five Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices

In average 1985 dollars.

Year Ended December 31 (Dollars in thousands, except per share and price index data)	1985	1984	1983	1982	1981
Operating revenues	**$2,655,491**	$2,532,210	$2,371,189	$2,092,537	$2,193,290
Current Cost Information					
Earnings (loss) before extraordinary loss	**5,555**	(4,306)	(164,993)	(185,707)	(159,800)
Per share data	**.27**	(.20)	(7.03)	(8.60)	(7.36)
Excess of increase in specific prices of property and equipment over increase in the general price level	**94,191**	82,187	464,507	259,564	121,357
Net assets at year-end	**2,134,641**	1,742,939	2,881,100	2,580,869	2,577,433
Other Information					
Purchasing power gain from holding net monetary liabilities during the year	**27,772**	18,501	14,894	15,200	45,982
Cash dividends declared per common share	**.90**	.85	.86	.89	.95
Market price per common share at year-end	**46.00**	42.20	48.32	52.38	31.94
Average consumer price index	**322.2**	311.1	298.4	289.1	272.4

Statement of Earnings The accompanying supplemental statement of earnings presents income data under two measurement methods. These are:

a. As Reported in the Primary Statements—This amount is net earnings as reported in the primary financial statements on the historical cost basis of accounting. Under generally accepted accounting principles the effects of changing prices generally are not recognized for assets and liabilities.

b. Adjusted for Change in Specific Prices (Current Costs)—Income under current cost accounting attempts to reflect the effects of changes in specific prices of the resources actually used in operations so that measures of these resources and their consumption reflect the current cost of replacing these resources, rather than the historical cost.

Income Taxes Current tax laws do not recognize deductions for current cost depreciation expense; therefore, no adjustments have been made to the provisions for income tax.

Purchasing Power Gain from Holding Net Monetary Liabilities During the Year When prices are increasing, the holding of monetary assets (e.g., cash and receivables) results in a loss of general purchasing power. Similarly, liabilities are associated with a gain of general purchasing power because the amount of money required to settle the liabilities represents dollars of diminished purchasing power. The net gain in purchasing power is shown separately in the accompanying supplemental data. The amount has been calculated based on the Company's average net monetary liabilities for the year multiplied by the change in the CPI for the year. Such amount does not represent funds available for distribution to stockholders.

Increases in Current Cost of Properties Under current cost accounting, increases in specific prices (current cost) of properties held during the year (including realized gains and losses on those sold) are not included in income from continuing operations but are presented separately. The current cost increase is reduced by the effect of general inflation measured by applying the annual rate of change in the CPI to the average current cost balances of properties.

Note K—Supplemental Information on the Effects of Changing Prices (Unaudited)—Continued

Current Cost Measurements

The current cost of property and equipment has been estimated by management using pricing data for aircraft still in production furnished to the airline industry by the Air Transport Association and current market values for nonproduction aircraft. Flight equipment represents approximately 90% of the property and equipment.

Current cost depreciation is based on the average current cost of properties during the year. The depreciation methods (straight line), salvage values and useful lives are the same as those used in preparing the primary financial statements.

Current cost calculations involve a substantial number of judgments as well as use of various estimating techniques that have been employed to limit the cost of accumulating the data. The data reported should not be thought of as precise measurements of the assets and expenses involved, but instead represent approximations of the price changes that have occurred in the business environment in which the Company operates.

Current cost does not purport to represent the amount at which the assets could be sold.

Stockholders' Information

Stock Prices and Dividends

Quarter		Sales Price of Common Shares 1985	Sales Price of Common Shares 1984	Dividends Per Share 1985	Dividends Per Share 1984
1st	High	**$46¼**	$49	**$.225**	$.20
	Low	**40¼**	34½		
2nd	High	**55¾**	41⅜	**.225**	.20
	Low	**37¼**	34⅜		
3rd	High	**59½**	42	**.225**	.20
	Low	**47⅝**	33½		
4th	High	**58¼**	42¼	**.225**	.225
	Low	**46**	35⅜		

Stock listed Common Stock listed on New York Exchange, Pacific Stock Exchange and Midwest Stock Exchange. There were 6,384 stockholders of record as of February 28, 1986.

Co-Registrars and Transfer Agents Norwest Bank Minneapolis, N.A., Minneapolis, MN; Norwest Trust Company, New York, NY.

Notice of Annual Meeting The 1986 annual shareholders' meeting will be held at Northwest Airlines General Offices, Minneapolis/St. Paul International Airport, St. Paul, Minnesota, on Monday, May 19, 1986, at 9:30 A.M.

Accountants' Report

To the Stockholders and Board of Directors
NWA Inc.
Saint Paul, Minnesota

We have examined the consolidated statements of financial position of NWA Inc. and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of earnings, stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of NWA Inc. and subsidiaries at December 31, 1985 and 1984, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Saint Paul, Minnesota
February 18, 1986

10 Year Summary* NWA Inc. (Dollars in Thousands Except Per Share Figures)

Year Ended December 31	1985	1984	1983	1982†	1981	1980	1979	1978†	1977	1976
Operating Revenues										
Passenger	**$ 2,154,394**	$ 1,984,999	$ 1,812,227	$ 1,567,986	$ 1,521,856	$ 1,347,830	$ 1,067,214	$ 557,401	$ 861,053	$ 786,414
Freight	**328,400**	355,336	289,170	205,018	221,691	190,837	160,716	87,077	121,185	119,882
Mail	**80,126**	58,339	55,585	60,451	59,786	57,305	38,685	18,944	29,894	25,137
Charter and other transportation	**55,959**	38,559	36,198	34,758	21,766	16,303	15,093	10,997	25,871	25,955
Nontransport	**36,612**	7,741	2,856	9,355	29,191	27,055	28,850	115,743	8,352	6,420
TOTAL OPERATING REVENUES	**$ 2,655,491**	$ 2,444,974	$ 2,196,036	$ 1,877,568	$ 1,854,290	$ 1,639,330	$ 1,310,558	$ 790,162	$ 1,046,355	$ 963,808
Operating Expenses										
Depreciation and amortization	**$ 182,563**	$ 167,203	$ 146,908	$ 136,651	$ 133,489	$ 124,078	$ 106,401	$ 104,970	$ 103,152	$ 102,713
Other	**2,395,841**	2,181,495	1,980,242	1,749,292	1,719,054	1,539,386	1,148,805	617,907	838,619	758,147
TOTAL OPERATING EXPENSES	**$ 2,578,404**	$ 2,348,698	$ 2,127,150	$ 1,885,943	$ 1,852,543	$ 1,663,464	$ 1,255,206	$ 722,877	$ 941,771	$ 860,860
Operating income (loss)	**77,087**	96,276	68,886	(8,375)	1,747	(24,134)	55,352	67,285	104,584	102,948
Interest expense	**(19,873)**	(4,268)	(3,548)	(7,216)	(14,135)	(15,831)	(1,635)	(3,376)	(6,518)	(14,035)
Other income and (deductions)—net	**7,529**	25,380	8,265	16,279	20,297	3,862	30,643	45,126	55,078	9,351
Earnings (loss) before taxes and extraordinary item	**$ 64,743**	$ 117,388	$ 73,603	$ 688	$ 7,909	$ (36,103)	$ 84,360	$ 109,035	$ 153,144	$ 98,264
Income taxes (credit)	**(8,376)**	30,521	23,530	(4,331)	(2,551)	(43,187)	11,885	47,194	60,425	46,527
Earnings[1]	**$ 73,119**	$ 55,964††	$ 50,073	$ 5,019	$ 10,460	$ 7,084	$ 72,475	$ 61,841	$ 92,719	$ 51,737
Earnings per average share[1]	**3.18**	2.44††	2.19	.23	.48	.33	3.35	2.86	4.29	2.39
Cash dividends	**19,586**	17,933	17,367	17,332	17,326	17,317	17,306	16,210	10,804	9,707
Dividends per share	**.90**	.825	.80	.80	.80	.80	.80	.75	.50	.45
Stockholders' equity	**947,001**	892,923	854,189	820,605	832,510	839,042	849,122	793,691	747,672	665,744
Number of shares outstanding at end of year	**21,774,251**	21,749,667	21,715,995	21,678,458	21,661,367	21,647,280	21,639,589	21,626,284	21,606,686	21,606,036
Book value per share at end of year	**$ 43.49**	$ 41.05	$ 39.33	$ 37.85	$ 38.43	$ 38.76	$ 39.24	$ 36.70	$ 34.60	$ 30.81
Assets and Long-Term Debt										
Flight property at cost	**$ 2,784,553**	$ 2,356,048	$ 2,080,299	$ 1,996,925	$ 1,992,015	$ 1,995,168	$ 1,779,770	$ 1,525,442	$ 1,510,447	$ 1,448,402
Flight property at net book value	**1,427,114**	1,151,930	976,501	1,019,071	1,110,965	1,200,495	1,094,556	922,615	962,957	924,537
Total assets	**2,320,006**	1,754,233	1,602,236	1,377,387	1,492,381	1,532,539	1,528,921	1,392,865	1,299,451	1,151,562
Long-term debt	**332,992**	100,000	100,000	—	12,500	62,500	100,000	100,000	100,000	122,000
Obligations under capital leases	**$ 161,101**	—	—	—	—	—	—	—	—	—
Unit Expenses										
Per available ton-mile	**39.8¢**	40.2¢	40.5¢	40.7¢	41.0¢	37.0¢	29.4¢	27.9¢	22.9¢	21.6¢
Per revenue ton-mile	**75.3¢**	74.7¢	76.0¢	80.3¢	83.9¢	80.6¢	63.4¢	65.7¢	54.4¢	50.5
Percent of operating revenues	**97.1%**	96.1%	96.9%	100.4%	99.9%	101.5%	95.8%	91.5%	90.0%	89.3%
Statistics—Scheduled Services										
Revenue plane-miles (000)	**159,337**	143,410	133,699	119,189	120,139	120,709	116,105	66,420	111,271	108,474
Available seat-miles (000)	**37,148,562**	32,663,660	29,511,287	26,257,466	24,813,981	24,904,355	24,028,928	14,302,037	22,968,489	22,228,259
Revenue passenger-miles (000)	**22,341,334**	19,772,355	17,711,929	15,675,194	14,251,932	13,810,889	13,298,161	7,018,305	11,100,412	10,758,683
Passenger load factor	**60.1%**	60.5%	60.0%	59.7%	57.4%	55.5%	55.3%	49.1%	48.3%	48.4%
Revenue passengers carried	**14,538,744**	13,215,907	12,718,468	11,356,165	11,144,785	11,501,148	11,636,170	6,574,901	10,354,808	9,818,343
Freight ton-miles (000)	**886,355**	965,868	835,197	600,198	616,285	529,434	504,753	302,153	458,143	467,399
Total revenue ton-miles (000)	**3,334,257**	3,103,799	2,750,946	2,307,475	2,186,815	2,048,349	1,956,217	1,079,681	1,676,470	1,647,317
Statistics—Total Operations										
Revenue plane-miles (000)	**161,186**	144,568	134,870	120,378	120,761	121,243	117,027	67,471	114,643	112,279
Available ton-miles (000)	**6,450,509**	5,837,972	5,255,086	4,635,415	4,519,768	4,495,666	4,265,640	2,594,632	4,109,110	3,982,743

*Not covered by Accountant's Report.
†Strikes adversely affected 1978 and 1982.
††After extraordinary loss of $30,903 or $1.30 per share resulting from the settlement of a lawsuit.
[1]See pages 18 through 21 for Management's Discussion and Analysis.

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St. Paul, Minnesota

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*also officers of NWA Inc.

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